IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 21 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE B.C.PATEL Sd/-
and
Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

DINESH MILLS LTD

Versus

COMMISSIONER OF INCOME TAX

Appearance:
MR JP SHAH for Petitioner No. 1
MR AKIL QURESHI FOR MR MANISH R BHATT
for Respondent.

CORAM : MR.JUSTICE B.C.PATEL
and
MR.JUSTICE D.A.MEHTA

Date of decision: 05/12/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

1 The Income Tax Appellate Tribunal, Ahmedabad Bench ,"A" has referred the following questions at the instance of the assessee as well as Commissioner under section 256(1) of the Income Tax Act,1961 (hereinafter referred to as 'the Act') :

At the instance of assessee :
Asstt.Year : 1977-78 only in
R.A.No.223/Ahd/87).

1 "Whether, on the facts and in the circumstances of the case, the Tribunal was right in disallowing the embezzlement loss of Rs.7,80,000 ?"

(For Asstt.Years : 1979-80 and 1980-81)
(In R.A.Nos.224 and 225/Ahd/1987).

2 "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in disallowing the commission paid to the Directors as perquisite in the asstt.years 1979-80 and 1980-81, for the purposes of section 40(c) of the Act ?"

At the instance of Revenue :
(Asstt.Years : 1977-78, 1979-80 & 1980-81)
(R.A.Nos. 241, 242 and 243/Ahd/1987) :

1 "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law to hold that sum of Rs.20,000/- out of motor car expenses in each of the asstt.years 1977-78, 1979-80 and 1980-81 was not disallowable as personal and non business use of motor car in the hands of the assessee ?"

For Asstt.Years 1979-80 :
(R.A.No.242/Ahd/1987) :

2 "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessee was entitled to the depreciation as claimed and 1/7th portion of the depreciation of motor car was not disallowable ?"

2 The assessment years are 1977-78, 1979-80 and 1980-81, and the relevant accounting periods are calendar years 1976 to 1979 respectively. The assessee is a limited company carrying on business in textiles and maintains the accounts by mercantile system of accounting.

3 In so far as the first question at the instance of the assessee is concerned, the same is relatable to assessment year 1977-78 only. The assessee company employed one Shri M.J.Patel as Clerk in the Accounts Department with effect from 2/7/1973. This clerk misappropriated various accounts during the tenure of his service as per following details :

From 29-1-1974 to 30-8-1974
(11 occasions) Rs.4,40,000/-

From 5-2-1975 to 12-10-1975
(8 occasions) Rs.5,20,000/-

From 9-1-76 to 26-4-76
(4 occasions) Rs.3,80,000/-

Rs.13,40,000/-
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4 The said loss was discovered during the year under consideration. However, the Income Tax Officer was of the view that the extent of loss remained indeterminate and unknown during the year under consideration, and the amount of actual loss could be known only when the assessee entered into compromise decree with the defaulter employee in calendar year 1980 relevant to assessment year 1981-82. Accordingly, the assessee's claim for loss was disallowed.

5 The C.I.T.(Appeals) in the appeal filed by the assessee held that the claim of the assessee that the entire loss of Rs.13,40,000/- should be allowed in the year under consideration and the stand of the I.T.O. that not a single supee claimed should be allowed as embezzlement loss were extreme positions and reasonable and just view would fall somewhere between respective positions taken by the assessee and the department. According to the Commissioner (Appeals) the whole amount of embezzlement had to be considered as comprising of two parts viz. the part which could reasonably be estimated

to be recoverable and the other part, if any, which could not be reasonably expected or estimated to be recoverable. This position had to be ascertained at the end of the previous year viz. as on 31/12/1976. Based on this line of reasoning, the Commissioner (Appeals) held that a sum of Rs.7,20,000/-, the assessee could have reasonably hoped to recover while the balance of Rs.6,20,000/- were lost by the assessee for all time to come. Accordingly, he granted deduction to the tune of Rs.6,20,000/- in assessment year 1977-78.

6 The assessee carried the matter in appeal before the Tribunal and relying upon the circular issued by Central Board of Direct Taxes being circular No.35-D(XLVII-20) of 1965 dated 24/11/1965 submitted that the approach of the learned Commissioner (Appeals) was not correct. It was pointed out that in a later year the assessee had in fact recovered an amount of Rs.5,60,704/and thus the balance of Rs.7,79,000/- was a total loss which ought to be allowed as a deduction. The revenue on the other hand supported the order of the Commissioner (Appeals). The Tribunal reproduced the last paragraph of the circular and held that the said circular provides for two aspects : firstly, that such embezzlement loss incurred by the assessee because of the employee had to be treated to be incidental to business and the second part was that the deduction had to be allowed in the year in which the loss was discovered. The Tribunal accepted the position that there was no dispute as to loss being incidental to business. In so far as the year in which the loss was allowable the Tribunal took it upon itself that even if it was established that the loss was discovered during the year under consideration, it was yet open to the Tribunal to ascertain whether there was any loss in fact incurred or not. Referring to the Supreme Court decision in the case of Associated Banking Corporation of India vs. CIT (1965) 56 ITR 1, the Tribunal held that till the point of time reasonable prospects of recovery of the amount embezzled existed it could not be stated that a trading loss in a commercial sense had been incurred. Further, referring to the suit which was filed by the assessee against the employee and the compromise which had been arrived at during the calendar year 1980, the Tribunal held that till that point of time the assessee entertained the hopes regarding recovery of loss and hence the full amount of Rs.13,40,000/- was not allowable during the assessment year under consideration. In light of this finding, the Tribunal upheld the order of the Commissioner (Appeals) and rejected the appeal of the assessee.

7 We have heard Mr.J.P.Shah, learned Advocate appearing on behalf of the assessee and Mr.Akil Qureshi, learned Counsel appearing on behalf of the revenue. Both the sides reiterated the contention raised by them before the Tribunal. Mr.Shah made a statement to the effect that in assessment year 1981-82, when the compromise decree was arrived at , though the assessee had claimed the balance amount of loss which was not allowed as a deduction during the year under consideration, the same was not allowed in light of the fact that the assessee was claiming entire loss during the year under consideration. He further stated that out of abundant caution even if in the appeal or further proceedings pertaining to assessment year 1981-82 any deduction, from the balance of loss was allowed, the petitioner assessee would not raise any objection and surrender the same for the purpose of taxability.

8. In view of the fact that Mr.Shah has made a statement to the effect that no deduction has been allowed in any subsequent year we hold that the assessee would be entitled to deduction of loss during the year under consideration as this is the year in which the loss on account of embezzlement was in fact discovered. There is no dispute as to the fact that the loss is incidental to business carried on by the assessee. The Tribunal while giving effect to this judgment shall ascertain the allowability or otherwise of the loss in light of the aforesaid statement made by Mr.Shah and then allow deduction of the balance amount of loss in the year under consideration.

9. In so far as the question No.2 at the instance of the assessee, pertaining to assessment years 1979-80, and 1980-81 is concerned, Mr.Shah has not pressed the said question and hence, it is not necessary to answer the same.

10. Both the questions referred to us at the instance of the revenue stand answered by unreported decision of this Court rendered on 25/7/2001 in Income Tax Reference No.158 of 1986 in the case of Sayaji Iron & Engg.Co. vs. C.I.T. and hence it is not necessary to set out the facts and submissions in detail.

11. Question No.1, referred at the instance of the assessee, is therefore answered in the negative i.e. in favour of the assessee and against the revenue.

12. Question No.2, referred at the instance of the

assessee, is left unanswered as the same has not been pressed on behalf of the assessee.

13. Both the questions referred at the instance of the revenue are answered in the affirmative i.e. in favour of the assessee and against the revenue.

14. The reference stands disposed of accordingly with no order as to costs.

Sd/- Sd/-

(B.C.Patel,J) (D.A.Mehta,J)

m.m.bhatt